BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 94-615-E - ORDER NO. 95-26

JANUARY 12, 1995

IN RE: Joint Application of Cherokee County Cogeneration Corporation and Duke Power Company for Approval of Purchased Power Agreement.	))))	ORDER APPROVING PURCHASED POWER AGREEMENT

This matter comes before the Public Service Commission of South Carolina ("the Commission") by way of the joint Application of Cherokee County Cogeneration Corporation ("Cherokee") and Duke Power Company ("Duke"), dated August 29, 1994, in which Cherokee and Duke request Commission approval of a Purchased Power Agreement, dated August 26, 1994 ("the Agreement"). Under the terms of the Agreement, Cherokee will sell, and Duke will purchase, electric capacity and energy, which will be produced by a cogeneration facility ("the Facility") which Cherokee will own and operate in the vicinity of Gaffney, South Carolina. The joint Application also requested the Commission to make certain determinations with respect to the prudency of the Agreement and Duke's recovery of the costs of the purchases of power and energy.

Upon receipt of the joint Application, the Commission issued its Order No. 94-1044, dated September 30, 1994, which set this matter for hearing. Thereafter, by letter dated October 7, 1994, the Commission's Executive Director instructed Duke to publish a

prepared Notice of Filing in newspapers of general circulation in the area affected by the Application. The Notice of Filing advised all interested parties of the Application and of the manner and time to file the appropriate pleadings for participation in the proceeding. Duke submitted affidavits of proof of publication of the Notice of Filing. Petitions to Intervene were received from the Consumer Advocate for the State of South Carolina ("Consumer Advocate") and Charles B. Mierek.

Pursuant to due notice, the Commission convened a public hearing on December 21, 1994, in the Commission's Hearing Room at 111 Doctors Circle, Columbia, South Carolina. Jeffrey M. Trepel, Esquire, and Richard L. Whitt, Esquire, represented Duke; Robert T. Bockman, Esquire, represented Cherokee; Nancy Vaughn Coombs, Esquire, and Elliott F. Elam, Jr., Esquire, represented the Consumer Advocate; William E. Booth, Esquire, represented Mr. Mierek; and Gayle B. Nichols, Staff Counsel, and Florence P. Belser, Staff Counsel, represented the Commission Staff.

The record in this proceeding consists of the Application and the evidence offered by one witness for Cherokee and one witness for Duke. Based on the evidence of record, the Commission makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

1. Cherokee intends to construct, own, operate, and maintain a natural-gas-fueled combined-cycle electric cogeneration facility in the vicinity of Gaffney, South Carolina. Integral with the Facility, Cherokee will construct and operate a hydrocarbon

processing facility using a "proprietary process" which will include a thermal absorption process system. All steam produced through the operation of the hydrocarbon processing facility will be retained for use by Cherokee. The Facility is a qualifying facility ("QF") under the rules and regulations of the Federal Energy Regulatory Commission ("FERC"), promulgated pursuant to the provisions of Section 210 of the Public Utility Regulatory Policies Act of 1978 ("PURPA"), 19 U.S.C. §§ 2601 et seq. (1978). Cherokee has obtained FERC's determination of its status as a QF pursuant to the certification procedure set forth in FERC's Rules and Regulations. (QF No. 94-160-000, issued by FERC on September 19, 1994). The Facility will have an installed generating capacity of approximately 80 megawatts (nameplate rating). [Cherokee has filed an Application for a Certificate of Environmental Compatibility and Public Convenience and Necessity from this Commission pursuant to S.C. Code Ann. §58-33-10 et seq. (1976). Cherokee's Application is currently pending in Docket No. 94-684-E.]

2. Under the provisions of the Agreement between Cherokee and Duke, which was negotiated over a period of approximately two (2) years, and executed on August 26, 1994, Cherokee will deliver and sell to Duke, and Duke will accept and purchase, all of the net output of the Facility over the term of the Agreement. The Capacity Commitment, or firm capacity, of the Facility is 72,700 kilowatts.

3. The initial term of the Agreement is fifteen (15) years,

beginning on the Facility's Commercial Operations Date, which the parties anticipate to be November 1, 1996. The Agreement also provides Cherokee an option to extend the Agreement for one additional five (5) year period beyond the expiration of the initial term.

4. The Agreement contains a rate schedule ("Cherokee Schedule 1") which sets forth the energy and capacity rates for each year of the initial term of the Agreement. The rates in Cherokee Schedule 1 are twenty-four percent (24%) lower, on a net present value ("NPV") basis, than the projections of avoided capacity and energy costs which Duke estimated at the time of the final rate negotiations between Duke and Cherokee in September 1993 which led to the Agreement. Since the conclusion of the final negotiations and the execution of the Agreement, Duke has estimated avoided cost projections which are lower than the rates contained in the Agreement. The methodology for the determination of avoided capacity and energy costs is consistent with the methodology which this Commission has previously adopted.

5. The Agreement includes provisions which are intended, in part, to protect the interests of Duke and its customers. For example, Duke may reduce capacity payments or recover liquidated damages for the purchase of replacement power in the event Cherokee fails to deliver the committed capacity. In addition, the Agreement contains provisions requiring Cherokee to post security to ensure the availability of liquidated damages in the event of early termination or capacity reduction, and to post

security at the various "Milestones" which were established to ensure the Facility becomes operational at the anticipated commercial operation date. Notice provisions, a "regulatory out" provision and a provision dealing with extended forced outage will enable Duke to protect the interests of its customers under the applicable circumstances. The Agreement also provides that Cherokee will reduce the output of the Facility by approximately twenty-five percent (25%) during off-peak hours to permit Duke to take advantage of the availability of its other resources with low off-peak energy costs.

6. The Agreement is intended to be consistent with PURPA and the regulations of the FERC which implement PURPA. Those regulations require electric utilities like Duke to interconnect with QFs like Cherokee, and to purchase capacity and energy which those QFs make available at the utility's avoided costs. (See, 18 CFR §292.101 and 18 CFR §292.301 through 304.) In the determination of avoided costs, FERC's regulations allow for the use of estimates of future avoided costs to establish purchase rates for long-term contracts with QFs and a utility, and the parties may establish rates based on estimates of future avoided costs which might differ from the utility's actual avoided cost at the time power is delivered. [See, 18 CFR §292.304(b)(5) and §292.304(d) and 18 CFR §292.301(b)]. In adopting its regulations, FERC made it clear that it intended that contracted rates with QFs would remain fixed, even if they deviated from actual avoided cost, in order that both the utility and the QF could retain the

benefit of the bargain for which they had contracted. (See, 45 Fed. Reg. 12224, February 25, 1980.) In other words, the utility would not have to pay higher prices if the agreed price was below avoided costs, and the QF would not have to accept lower prices if the agreed price was above avoided costs.

7. The Agreement is also intended to comply with the Commission's previous orders pertaining to the implementation of PURPA. The Commission has expressed its encouragement of cogeneration and small power production, and of good faith negotiations between jurisdictional utilities and QFs to reach voluntary agreements for the purchase of capacity and energy. (See, Order No. 81-214, dated March 20, 1981; Order No. 85-347, dated August 2, 1985; and Order No. 89-56, dated February 8, 1989, issued in Docket No. 80-251-E.)

8. The Agreement is also intended to be consistent with Duke's Integrated Resource Plan ("IRP") which includes provisions for incorporation of purchased resources, including PURPA-mandated power supply purchases from QFs like Cherokee's Facility. (See, Order No. 93-8, issued in Docket No. 92-208-E, dated January 25, 1993, which approved Duke's current IRP.) Duke's IRP and subsequent Short Term Action Plans for 1993 and 1994 include discussions of Duke's purchased resource planning process.

CONCLUSIONS OF LAW

1. The Agreement is consistent with the provisions of PURPA and the implementing regulations of FERC, which the Commission has previously adopted as appropriate guidelines for its policies to

implement the requirements of PURPA in South Carolina.

2. The Agreement is consistent with the policy which the Commission has adopted and articulated in its Orders concerning the negotiation of arrangements between jurisdictional electrical utilities and QFs for the purchase of capacity and energy under the requirements of PURPA.

3. Duke's purchase of capacity and energy from Cherokee is consistent with Duke's IRP and the Purchased Resource Planning Process which the IRP and Short Term Action Plans describe.

4. The Agreement reflects rates and charges for capacity and energy which were below Duke's estimated avoided costs through the year 2007 as estimated at the time the parties negotiated the rate provisions of the Agreement in September 1993, and when they finally executed the Agreement on August 26, 1994. While Duke's more recently forecasted avoided cost estimates are lower than the avoided costs incorporated in the rates and charges of the Agreement, the Commission recognizes the limitation on the accuracy of avoided cost estimates over the terms of Purchased Power Agreements. Changes in forecasts of demand and energy requirements, plant operations schedules and operating costs, changes in capital costs and construction schedules, and a variety of other factors serve to change a utility's estimate of avoided costs which might be expected and experienced in any future period. It is not unexpected that the current estimates of Duke's avoided costs are different now from the avoided cost estimates the parties used in their negotiations, and which existed at the

time of the execution of the Agreement. Likewise, it is to be expected that future estimates of avoided costs will differ from Duke's current estimates. Our review of the Agreement's provisions should look to the conditions at the time the parties negotiated and entered into the Agreement. At that time, the rates and charges upon which the parties based their bargain and concluded the negotiations which produced the Agreement were lower than Duke's filed and approved avoided cost estimates, upon which standard, long-term avoided cost rates were approved by the North Carolina Utilities Commission. However, this Commission has not approved long-term avoided cost rates at this time.

5. Because the Agreement is consistent with the applicable provisions of law and our policies and Orders, the Commission concludes that the Agreement is reasonable and prudent, and that Duke's anticipated payments for purchased power would constitute reasonable and prudent expenditures based upon the information available at the time of this determination.

6. The Commission's approval of the Agreement and its determinations herein would be subject to re-evaluation and change should the Commission later find that our conclusions of reasonableness and prudency were induced through perjury, fraud, collusion, deceit, mistake, inadvertence or the intentional withholding of material information.

IT IS THEREFORE ORDERED THAT:

1. The Purchased Power Agreement dated August 26, 1994, between Cherokee County Cogeneration Corporation and Duke Power

Company be, and hereby is, approved.

2. Duke and Cherokee shall file any subsequent amendments or modifications to the Agreement within ten (10) days of execution of such amendments or modifications.

3. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Rudolph Mitchell
Chairman

ATTEST:

Gary E. Walsh
Deputy Executive Director

(SEAL)